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# Financial Assistance Programs in Maryland



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Financial Assistance Programs in Maryland:

The Provision for Capital Needs;

Effectiveness in Practice;

and

Coordinative Function

A Report to the Task Force on State Economic Development

by

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Most of the information on which this report is based comes from interviews with people in the field who have been kind enough to give their time and assistance to the project. In developing positions and conclusions stated in this report, information so obtained has not been used unless corroborated by at least two other sources. The names and titles of the interviewees are part of the bibliography. Other sources of information are noted both in the text and in the bibliography. The author is most grateful for this help and accepts sole responsibility for any inaccuracies of fact or misrepresentations.



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a proportional basis.

In practice, weaknesses inherent in the first three programs reduce their effectiveness and make their future growth in use uncertain. IRBs' attractiveness to purchasers depends on their tax-exempt status. Issuance is not subject to any review at the state or regional level. The more widespread their use, the less competitive advantage in attracting and retaining industry. Severe overuse and the resulting oversupply could destroy their market entirely. Salability of IRBs depends on the reputation and credit worthiness of the firm involved; fixed costs of issuing bonds are high. As a result, IRBs are used primarily by large established firms. Use of such bonds to finance intrastate relocation might result in no net gain in economic activity for the state as a whole.

MIDFA also relies on its tax-exempt status to attract business. Like IRBs, MIDFA loans are placed with local commercial banks. Concern with job generation and with credit worthiness of the applicant has resulted historically in a conservative preoccupation with large and medium-sized manufacturing firms. To date, MIDFA has been reluctant to deal with small businesses, with businesses other than manufacturing, or to make medium-term loans.

Of greatest importance is the overreliance of these programs on participation by commercial banks. IRBS, MIDFA and DCCM all deal primarily with these institutions but of the three, only DCCM makes involvement in its loans financially attractive to the banks. IRBs and MIDFA's tax exemption is of dubious benefit while the liquidity loss involved with their loans strains a bank's willingness to participate. Whatever revisions might be contemplated, it is clear that state monies should be used in a more direct manner to broaden the base of its programs. State policy of leveraging funds from the private sector should be tempered.



Economic expansion raises issues of firm location, designation of growth areas and environmental-industrial trade-offs which can only be resolved within the framework of a coordinated policy. Due to the absence of political support, both from the governor and the local jurisdictions, no such economic development policy exists at the state level. The financing programs lack effective internal links or legal authority to perform coordinative functions. As a result, there is no recognized policy at the departmental or agency level. As presently structured, financial assistance does not foster coordination of state/local development efforts. Such coordination cannot be achieved until political subdivisions, of their own volition, adopt a regional or statewide perspective.

domestic expansion means means of first location, distribution of goods  
and services, and the industrial structure of the economy. It is  
the framework of a country's economic life, and it is the basis of  
its economic development. The government and the people must work  
together to develop the economy and to improve the living standards  
of the people. The government should provide a stable and favorable  
environment for economic growth, and the people should work hard  
to increase production and efficiency. Only in this way can the  
country achieve economic prosperity and social harmony.

Like all other countries, China is facing many challenges in  
the field of economic development. However, China has a long  
history of economic development, and it has a strong foundation  
for future growth. China's government has implemented a series of  
reforms and opening-up policies, which have led to rapid economic  
growth and significant improvements in the living standards of the  
people. China's economy is now becoming more diversified and  
competitive, and it is attracting more foreign investment.

China's economic development is not only in the interest of China  
itself, but also in the interest of the world. China's growth  
can help to reduce poverty and promote global economic development.  
China's government is committed to maintaining a stable and  
peaceful environment, and it is working to improve its  
international relations. China's economic development is a  
continuous process, and it will continue to face challenges in  
the future. However, China's government and people are confident  
that they can overcome these challenges and achieve a bright  
future for the country.

## I. INTRODUCTION

Over the last decade, state and local governments have become increasingly concerned with economic development. The recent national economic recession which exacerbated urban fiscal problems, focused attention on the close relationship between jobs and business development. Growing public awareness of this close relationship has forced reconsideration of the effectiveness of traditional approaches - public works and social service programs - in solving chronic unemployment and fiscal deterioration. Historically states have been slower than the federal or local governments to take the initiative in promoting a public/private investment process. In the last few years, however, state action has increased along two lines. The first, broadening the powers of local jurisdictions which may be limited by state constitution, includes such powers as property tax abatement, delegated eminent domain, liberal developer earnings, tax increment financing, special tax assessments, citywide economic development corporations, and metropolitan tax-base sharing [2, p.1]. The second line, the provision of financial support for development activities, is the subject of this report.

There are several justifications for state financial involvement: correction of perceived imperfections in private capital markets; encouragement of immigration of business, of existing businesses to stay and expand, the incubation of new businesses, all of which will generate jobs and tax revenues; balancing of economic activity by helping depressed areas overcome locational disadvantages. Most important is the growing realization that the fragmentation of development efforts among political jurisdictions can

and often does work to the detriment of the state as a whole. Coordination is needed at a level above local government but not so distant as the federal one. The choice of state government as the logical vehicle has been supported by the 1974 Amendment of the Federal Public Works and Economic Development Act which specifies that Section 302 funds be used to encourage the creation of a planning process at the state level to coordinate state/local development efforts.

There are many programs which potentially fall under the heading of financial support for development activities. Using the broadest definition of economic development, any state monies expended for environmental, land-use, job-training, tax-incentive or technical assistance activities could be considered such support. This report will focus on state financial programs as the means of meeting capital needs. It will examine the types of capital which in general are needed by businesses; Maryland programs will be discussed in terms of their legal provisions and of their effectiveness in actual practice. Whenever possible, provisions in other states' programs will be examined as either alternatives or supplements to what is available in Maryland. Finally, the effectiveness of financial tools as a means of achieving state aims and of aiding coordination of state/local development activities will be considered.

## II. FIVE TYPES OF CAPITAL FOR BUSINESS NEEDS

Capital needs of business may be divided into five categories.<sup>1</sup> Long-term capital which can be repaid over a period of ten years or longer is required for major investments in land, plant and equipment. While such monies are often raised internally by retained earnings or new stock issues

or externally through conventional lending institutions, medium or small-sized firms<sup>2</sup> may have difficulty in obtaining sufficient funds at a price they can afford. High fixed costs of bond issues and of mortgage servicing as well as the unknown credit worthiness of such firms contribute to the difficulty.

Medium-term expansion capital, both for fixed assets and for software associated with plant expansion, such as market research, advertising and staff, also is usually provided by internally generated funds or by loans from conventional lenders. The loans are generally term loans, secured or unsecured, running from 3 to 7 years, with interest rates adjusted periodically to reflect changes in the prevailing interest rate. Medium and small-sized firms face the same problems in finding such financing as they do for long-term capital. Periods of tight capital compound their difficulties.

Short-term working capital is usually borrowed for a few months to one year to finance inventories and accounts receivable and to support expanded operations for small businesses. Although commercial banks and finance companies are the principal sources of such financing, small businesses may be squeezed out of the market or be forced to pay debilitating interest rates, especially during periods of tight credit.

New business is considered high risk investment since managerial ability is not known and the firm's cash flow is unpredictable. Thus the mixture of short, medium and long-term capital needed by new businesses is hard to acquire. The traditional sources of such capital - loans and equity investments by individuals, investment companies and investment bankers that specialize in new stock issues - have diminished since the 1969 recession. As a result of the decline of the new stock issues market and the availability of other lower risk investments with high yields, equity investors have been

less interested in providing capital for new businesses.

Capital for new products and technological innovations faces all these problems and more. Even large established firms find it difficult to raise such capital because of uncertainties about pricing, production costs and marketability. Capital is needed at both the development and production stage. The former includes research, engineering and marketing costs; the latter, costs associated with construction and equipment of facilities needed to manufacture the new product or service.

Most current state financing programs provide long and medium-term capital. Few states take part in business start-ups and new product development capital. The private financial market in general has been very efficient in supplying needed short-term working capital, gaps in its coverage being met by development credit corporations. Thus the importance of variations among states' financial assistance programs is not in the types of capital provided but in the means by which such capital is made available.

### III. PROVISION OF LONG-TERM CAPITAL IN MARYLAND

#### A. Industrial Revenue Bonds

In Maryland public sector provision of long-term capital is available through general obligation and industrial revenue bonds (IRBs) issued by the local governments themselves.<sup>3</sup> In 1960, Article 45A, Sections 1-3 [21] authorized the counties and Baltimore City to issue general obligation "industrial development bonds," at 5 1/2% interest rate, 30 year maturity, exempt from state and local taxation. The proceeds were to be given to the industrial development corporation in each jurisdiction (a non-stock, non-profit corporation) to be used as it saw fit to encourage and promote industrial development.

In 1963, Article 41, Sections 266A-266I [23] empowered all municipalities and counties to issue industrial development revenue bonds, of 25-year maturity with negotiable interest rates. These limited obligations are state and local tax-exempt. If the bond issue for any one project is \$1 million or less, the interest payable will be exempt from federal income taxation, regardless of the total amount of capital expenditure by the user in that political subdivision. A bond issue of up to \$5 million for a single project may also qualify for federal tax exemption if total capital expenditure by the user does not exceed that amount for the six year period starting three years before and extending three years after issuance of the bonds.

Proceeds may be used for the acquisition, by purchase or construction, of an industrial building or port facility, including the purchase of the land necessary for such buildings. The definition of an industrial building is very broad: any structure to be used as a factory, mill, shop, processing plant, research and/or development laboratory, warehouse, assembly plant, fabricating plants and rented offices, office buildings for use as corporate or company headquarters or regional offices. Necessary machinery and equipment is included, as are pollution control facilities for both new and existing buildings or port facilities. The local jurisdiction may either lease the structure to the company or lend the bond proceeds directly to the company for acquisition.

In 1976, Article 41 was amended (Sections 266A1-3) [22] to extend the authority to issue IRBs to local industrial development authorities, created by the county or municipality. The unstated purposes of this amendment was to encourage more consistent financing policy by removing it one step from the immediate political process, and to promote expertise by the establishment of an ongoing staff.

B. Maryland Industrial Development Financing Authority

There is no program in Maryland of state loans made directly to industry for any type of capital, long, medium or short-term. Instead, indirect financial assistance for long-term capital needs is offered by state insurance of mortgage loans through MIDFA, the Maryland Industrial Development Financing Authority. Established by state legislation in 1965 (Article 41 Sections 266J-266CC) [24], MIDFA is a public instrumentality of the state, whose primary purpose is to aid economic development by encouraging the making of mortgage loans by the private sector.

To qualify under the act, a mortgage may not exceed 25 years on land or buildings or 15 years on equipment and machinery; nor may it be for more than 100% of the cost of the project. Insurance up to 90% of the cost of real property and 70% of the cost of machinery and equipment is offered, with an insurance limit of \$5 million per project. Project costs are defined to include real property acquisition, construction, site improvement, as well as equipment and machinery. There are six categories of projects eligible under Section 266-0(3): 1) construction of a new, or acquisition, refinancing, rehabilitation or improvement of a former industrial or manufacturing plant; 2) buildings used primarily for storage or transshipment of manufactured goods; 3) buildings to be used for research and development of new processes or products; 4) construction, acquisition, rehabilitation or improvement of tourist or convention facilities which may include mercantile, retail or service establishments if they are to be used primarily by or for tourists or conventioners; 5) mercantile, retail or service facilities that primarily serve out-of-state markets; 6) office buildings for use as corporate headquarters or regional offices. In 1975, Section 266-0(3) was amended to include



categories 5 and 6; at the same time, category 4 was rewritten with the intention of clarifying what constitutes tourist facilities and related retail/service establishments.

While the interest rate on the mortgage is determined by the private lender, the premium rate on insurance is legally set at a maximum of 3% per year of the outstanding principal obligation of the mortgage. The premium may vary at the discretion of the authority and is waived entirely for projects in jurisdictions whose unemployment rate exceeds the national average by 1% or more. The mortgagor may be either a municipality or county, its local development corporation or IDA, or the business applicant itself. If the mortgage is granted to a local government or its agency, the interest income to the lender is exempt from both state and federal taxation. If the firm is mortgagor, tax exemption is foregone.

#### C. Direct Loans Under The Industrial Land Act

Direct loans for long-term capital are provided by the state, but only to counties or Baltimore City for limited purposes. Loans for Land banking, industrial park development and speculative building are offered under the Industrial Land Act of 1972 which is administered by the Division of Business and Industrial Development, Maryland Department of Economic and Community Development (Article 41, Sections 438-446) [25]. Section 440 provides state loans to local governments of up to 100% of market value for acquisition of land suitable for industrial development. The loans are long-term. Interest only is payable for the first five years. If no sale or lease occurs within that time, the balance is amortized over 25 years. In the event of partial sale or lease, the balance is amortized over a 40 year period. Interest rates on this and all loans under The Industrial Land Act are set at 1/8 of one percent above the current effective

rate offered for state general obligation bonds.

Under Section 441, state loans of up to 50% are offered to local governments on a matching fund basis for costs associated with industrial park planning and development, with a limit of \$1 million per project. Interest only is required for the first two years, after which the balance is amortized over a 25-year period. Costs qualifying under this section include land, infrastructure and rehabilitation of buildings, but not construction or equipment.

Section 441A offers loans to political subdivisions for shell buildings. A limit of \$1,500,000 per project is divided into \$750,000 for costs incurred before a tenant is found and \$750,000 for completion of the building to user's specifications. The terms of the loan require payment of interest only for 2 years. In the event of sale, the entire debt must be retired. If no sale occurs, the balance is amortized over 25 years.

#### IV. EFFECTIVENESS OF LONG-TERM CAPITAL PROGRAMS IN PRACTICE: POSSIBLE ALTERNATIVES

When these three long-term capital programs are viewed in operation, it becomes evident that inherent weaknesses, both in structure and in application, make their effectiveness questionable. In particular, none of them serves the long-term capital needs of small firms. Further, both IRBs and MIDFA rely heavily on participation by commercial banks and other institutional lenders for their continued success. IRBs and MIDFA are potentially weak both as financial mechanisms and as means of effecting state aims.

##### A. Industrial Revenue Bonds

Maryland is among the very few states in the nation in which IRBs are issued by the local county council or commission itself rather than

by a local or state agency, in spite of recent state authorization for creation of Industrial Development Authorities. Unlike Pennsylvania, in which bonds issued by local IDAs are subject to review by the State Secretary of Commerce [7, p.3], there is no overview required at either the regional or state level. This close tie to the local political process hinders hinders continuity in economic development efforts both within and among political subdivisions.

In Maryland, much public sector financing of long-term capital is provided by IRBs, the majority of which are purchased directly by local banks. IRBs' marketability depends in part on their tax-exempt status and on the public-spiritedness of the banks involved. The weakness of this position will be discussed more fully later.

IRBs have been increasingly criticized nationally because their use is so widespread that they offer no competitive advantage in attracting or retaining industry [3, p.2]. Furthermore, without some form of cooperation among the issuing jurisdictions, excessive use of IRBs may produce an oversupply which would destroy the market for such issues entirely.

Since salability of bonds depends on the firm's reputation and credit worthiness and fixed costs of issuing bonds are relatively high, new businesses as well as established small ones are excluded from using them.<sup>4</sup> Given the purchaser's desire to minimize risk, IRBs are biased towards firms with easily identifiable success potential, although a project with lesser short-term potential may have greater indirect and long-term impact on the economy.

The tendency to assist well established firms with good credit ratings exposes IRBs to possible misuse. Although no public monies are directly involved, IRBs' tax exemption constitutes a state and/or federal interest rate subsidy; loss of tax revenues result from the reduction of the cost of capital to the borrower. If, upon evaluation, a firm's success potential appears

somewhat risky and the interest rate offered by a commercial bank is correspondingly high, then the difference between rates available through conventional financing and those offered by an IRB becomes a state or federal subsidy which effectively underwrites the perceived risk in order to make capital available at a price the firm can afford. But if the firm involved has an excellent credit rating and could borrow from a commercial bank at close to prime rate, there is no risk being underwritten. In this case, the IRB mechanism further reduces the cost of borrowing although capital at a manageable price is available from another source. Under these conditions, such use of IRBs is questionable. The purpose of public sector involvement in capital availability, however indirect, is to correct deficiencies in the private capital market, not to replace it. To issue IRBs for businesses which are prime candidates for commercial loans would make this public sector mechanism a competitor of the private capital market rather than a supplement.

In response to the problems faced by smaller firms in using IRBs, Connecticut has formed The Umbrella Revenue Bond Program, which issues a single bond on behalf of several small or medium-sized companies which could not act individually except at prohibitively high financing costs.<sup>5</sup> Connecticut also differs from Maryland in that a central state authority acts as principal issuer of bonds, not the local jurisdictions themselves.

### B. MIDFA and PIDA

Although MIDFA was created in 1965, funds for its use were not available until 1968 when the original method of funding which involved the full faith and credit of the state was found unconstitutional. At that time, a revolving mortgage insurance fund was established and a \$6 million appropriation from the state provided initial financing. Mortgage insurance involvement is limited statutorily to five times the balance in the fund. Increases in the fund through additional appropriations and accrued interest have raised the present limit to approximately \$80 million. Since its inception, MIDFA has been involved in mortgage loans totalling \$45 million. As of November 1977, such loans total \$37 million, \$29 million of which are covered by MIDFA insurance. Thus 36% of MIDFA's resources are in use at this time.

In practice, the Authority uses three criteria in evaluating an application for insurance. The first, that the business be engaged in a type of activity which fits the six categories already mentioned, is statutorily mandated. The second, that the project generate substantial economic impact, has been given an interpretation by MIDFA far narrower than the actual wording of the statute. Article 41, Section 266-0(3) states:

"A project may not be approved for insurance unless the Authority deems the economic impact of the project to be substantial. In determining whether or not the economic impact of a project is substantial, Authority may consider any factor it deems relevant, including the amount of insurance requested, the size of the loan, and the number of new jobs created by the project."

The first sentence was added to Section 266-0(3) in July 1971. The second sentence, in 1977. The statute is noncommittal as to which factors are of greatest importance. It has been Authority policy however to judge economic impact primarily in terms of the number of new jobs created. Priority of job creation, mentioned in past MIDFA brochures [9, p. 1], is given even greater emphasis in the 1977 revised publication.

"According to the MIDFA act, each loan, in the judgment of the Authority, must generate significant economic impact to the State and community where it is located. Generally the most significant factor in this regard is the number of new jobs to be created in relation to the overall scope of the project. Other factors, such as the generation of taxes or meeting specific needs of the local area are also taken into consideration." [10, p. 1].

The third criterion, credit worthiness, is strictly a matter of internal policy. Nowhere in the legislation is it mentioned as such. MIDFA's brochures however state that "to remain a viable force in stimulating Maryland's economic growth, it must not expose itself to unacceptable credit risks." [9, p. 2]. The value of collateral securing the loan, credit history, past and present financial condition and in particular, the applicant's ability to service the new debt are examined. [10, p. 1 and 5]. As evidence of credit worthiness, MIDFA usually expects the firm to take a 10% equity position in the project. [10, p. 5].

This conservative emphasis on credit worthiness and the use of number of jobs generated as the measure of economic impact has historically led MIDFA to concentrate on guaranteeing loans to large and medium-sized firms primarily in manufacturing. MIDFA recognizes that it was designed to assist companies of whatever size whose lack of credit strength precluded them from obtaining other forms of long-term capital financing, such as IRBs. [10, p. 2; 9, p. 1]. However, stringent application of its evaluation criteria has limited the amount of assistance offered to small firms.

As of February 1978, there are 62 loans in MIDFA's portfolio.<sup>6</sup> Information about present employment and net worth is available for 59 of the firms involved. If "small firm" is defined as one with 20 or fewer employees, only 10 MIDFA loans fall into this category. If "small firm" is defined as one having net worth of \$500,000 or less, 16 MIDFA loans fall into

this category. If "small loan" is measured by size of loan with an upper limit of \$250,000, 8 such MIDFA loans have been made, but the total dollar amount of these loans, \$1,397,500, accounts for only 3.2% of the dollar amount of the entire portfolio.

MIDFA's present involvement might have been even smaller had the firms involved not been in the manufacturing category for which MIDFA shows a decided preference. All 8 of the loans for \$250,000 or less were made to manufacturing concerns; all 10 firms with fewer than 20 employees were manufacturing firms; 14 of the 16 firms with \$500,000 or less net worth were manufacturing firms.

MIDFA is reluctant to become involved on a large scale with small firms and/or businesses outside of manufacturing, in spite of the recent extension of eligible categories to include firms serving out-of-state markets, tourist and convention facilities, and corporate headquarters or regional offices. As of February 1978, 95.1% of loans in which it is participating are for manufacturing and related warehousing. Only one loan has been made in each of three other categories: research and development, service facilities, and tourist facilities.

It is the particular nature of MIDFA's project evaluation process that hinders increased diversification. Because MIDFA has dealt and continues to deal almost exclusively with manufacturing concerns, its evaluation criteria have been structured to produce reliable assessment of projects in that one category. The kinds of information used, the functional characteristics of manufacturing concerns, and their markets--consideration of these factors has resulted in a method of applying criteria which is specifically suited to manufacturing. However the kinds of business activity into which MIDFA is authorized to expand may not be well suited to this method.

The problem is not simply whether or not criteria of job generation and credit worthiness are appropriate measures for other activities. They may well be so. But even assuming that they are, what confidence can MIDFA have in the predictive ability of these criteria when applied outside the category for which they were created? What kinds of information will give a reliable estimate of job generation for a tourist-related facility or a regional office? What information is needed to evaluate the credit worthiness of a research and development firm, whose internal structure and market opportunities are unlike those of manufacturing?

Furthermore, even assuming some evaluation by these criteria can be made, how stringent should the standards be? If a loan of \$300,000 is requested for a tourist facility project which would generate 10-12 jobs, how will MIDFA decide whether the employment potential is adequate in comparison to the size of the loan? Or, given a research and development project which will be labor intensive but whose financial future is uncertain, how great an emphasis should MIDFA place on credit-worthiness?

MIDFA has confidence in the ability of its evaluation process to make these trade-offs where manufacturing is concerned. That almost all its loans to small firms involved manufacturing indicates flexibility in the application of standards in that one category. However, outside of manufacturing, the problem of trade-offs becomes acute. Faced with uncertainty, MIDFA has taken the approach that projects in the other categories will be given the strictest appraisal possible, in the hopes that stringency in initial evaluation will safeguard MIDFA from involvement with projects which prove unsuccessful in the future. Considering that only three loans have been made outside of manufacturing, stringency may be a preventive as well as a safeguard. It is apparent that increased involvement along more diversified lines will require either the relaxation of standards applied to present criteria or the development of alternative criteria for evaluating eligible projects.



As originally enacted, MIDFA's role was to encourage new and expanded industrial enterprises within the state, by leveraging mortgage loans from the private sector. In 1974, Section 266-K was amended to include prevention of "the relocation of industry from the state." As a result, MIDFA's past pre-occupation with bringing in new firms from out-of-state has been modified. As of February, 1978, 69% of its activity involves expansion of preexisting industry; and it is participating in loans of as little as \$153,000.

The term of a loan is usually determined by the private lender, with the concurrence of MIDFA. Loans in which MIDFA has taken part average 20 years on real property and 7-10 years on equipment. Current insurance premium of 0.5% of the insured portion of the outstanding principal obligation is waived in jurisdictions with higher than national average unemployment. MIDFA's great strength is that its participation helps a client business borrow a higher percentage of costs for a longer term and at a lower rate of interest than normally would be possible through conventional financing. Although insurance is limited to 90% on real property and 70% on equipment, 100% financing can be achieved by agreement between MIDFA and the commercial lender. If a bank were willing originally to lend 60% of the costs of a project, MIDFA can specify that its 40% insurance covers the difference between what the bank is willing to undertake and total project costs. Assured of MIDFA's guaranteeing "the top of the loan," the bank often will provide 100% financing since the original collateral covers 60% of the loan and MIDFA has guaranteed the remaining 40%.

Furthermore, when the mortgagor is a political subdivision or one of its instrumentalities, interest income to the lender becomes exempt from federal income taxation. As a result, private lending institutions have been willing to lower the interest rate charged the borrower. For MIDFA loans, their spread below commercial rates is usually 3-3½%. In the past year or so, large regional banks have been offering 7-7½% on MIDFA loans; the same type of loan made without MIDFA participation might cost 10-10½%.

In terms of percentage of costs financed and of rates charged the borrower, what MIDFA offers is competitive with other states' programs of direct loans to industry. One of the most successful of these direct loan programs is administered by the Pennsylvania Industrial Development Authority (PIDA)<sup>7</sup>. Established in 1956, PIDA is financed by a revolving fund whose use is directed by an independent board. PIDA makes second mortgages to industry on projects proposed by local non-profit industrial development authorities (IDAs). Like MIDFA, PIDA offers up to 100% financing of costs but proceeds can be used only for acquisition or construction of buildings, not for machinery or equipment. Eligibility requirements for types of businesses are also more narrow than MIDFA's, limited to manufacturing plants, distribution facilities, and research and development projects. Both programs prefer to deal with industrial and manufacturing firms but in the case of PIDA, this focus is mandated by statute. PIDA funds are restricted to use in areas with an unemployment rate of 4% or more; and PIDA participation increases in direct proportion to the unemployment rate of the county involved.

The financing arrangement involves private lenders, PIDA and local IDAs. Local banks and other institutions provide a 50% mortgage at interest rates they set. Historically, the rates have ranged from 8-12%; at present they are 9½ to 10%. These are conventional loans, not tax-exempt. PIDA provides up to 40% second mortgage (a moratorium on 50% loans is in effect) at a rate of 4%. A third mortgage of 10% or more is provided by the local IDA; its rate may not exceed that of PIDA. At the moment, the average rate of interest for 100% financing of costs is 7%. PIDA loans run coterminously with the conventional first mortgage in a range of 10-20 years. Thus PIDA makes available medium as well as long-term loans for fixed-asset capital needs. Furthermore PIDA services both small and large firms; size of loans ranges from \$4,000 to \$5 million.

PIDA has been extremely successful. Of the \$400 million of loans it has made, only \$500,000 has been charged off since 1956. A comparison of the volume of business done by PIDA and MIDFA would be misleading. MIDFA did not really become active until 1971. State appropriations of \$12 million to MIDFA hardly compare to the \$188 million provided to PIDA. Furthermore PIDA is only one part of a well coordinated package to encourage business development in Pennsylvania; thus its limitations are compensated for by other state programs, like the state-supervised revenue bond and mortgage plan. Finally, unlike Maryland, Pennsylvania economic development has received enthusiastic support from both its local governments and its governor.

These factors notwithstanding, in one respect PIDA avoids a weakness inherent in MIDFA-the effect of such financing on rate of return to lenders. MIDFA relies on tax-exempt status to encourage private lenders to reduce their interest rates. Federal tax exemption is an uncertain proposition as are all federally mandated programs: what is presently allowed or funded may be disallowed or disbanded in the future. The possibility of loss of tax exemption does not adversely affect MIDFA's lenders. Step-up clauses, which are automatically included in loan agreements, and which require increases in interest rates to compensate for reductions in rate of return, provide for just such a contingency. However, loss of tax exemption would seriously impair MIDFA's future appeal to businesses since interest rates charged the borrower would increase.

More important, banks' interest in tax-exemption depends on many factors: their level of taxable income, the degree to which they wish to alter their tax bracket; the ease with which they can make 13% or 14% conventional loans; their willingness to accept the risk involved in such loans;

and the size and term of the tax-exempt loan.

From a bank's point of view, the attractiveness of tax-exempt interest rate is evaluated by comparison with rates of return of alternative uses of the loan portfolio. That is, given a specific tax-exempt rate, the rate of return on a conventional taxable loan necessary to produce the same yield. Variations in commercial rates depend on the bank's income tax bracket. For example, for a bank in the 50% tax bracket, a 12% interest rate on a conventional loan would be equivalent in yield to a 6% tax-exempt loan. For a bank in the 25% tax bracket, an 8% conventional loan would be the equivalent to a 6% tax-exempt loan. The higher the tax bracket, the higher the rate on a taxable loan necessary to produce an equivalent yield. A bank in the 50% tax bracket may well prefer to obtain a 7% yield from a tax-exempt loan in order to avoid the risk inherent in a 14% conventional loan. However, as tax brackets decrease, the equivalent rate on conventional loans decreases and the risk of default underlying the interest rate also decreases. Banks may find an 8% taxable loan preferable to a 6% tax-exempt one.

Banks' interest in tax-exemption is also closely tied to cycles in the national economy. Many large banks use tax-sheltered leasing arrangements, off-shore tax credits and other tax mechanisms to reduce their taxable income. If a bank is well tax-sheltered, it may have no taxable income, in which case tax exemption holds no appeal. For small banks which often do not use tax-sheltering arrangements and may be in tax brackets approaching 50%, a 6% tax-exempt loan might be attractive since it would produce a yield equivalent to a 12% conventional loan without increasing its taxable income.

Tax exemption benefits also vary with term and size of loan. Since interest rates of MIDFA loans are presently at about 7% and such loans are

long-term, this yield may be inadequate to counter the effects of inflation over a 15 or 20 year period. On the other hand, for small loans in the range of \$100,000, the expenses of arranging and administering the loan may reduce the yield below levels acceptable to the bank. Finally, MIDFA loans lack liquidity. They average 20 years on real property but have no secondary market such as municipal or county general obligation bonds enjoy.

The loss of liquidity and fluctuations in potential rate of return due to individual banks' response to shifts in the general economy seriously undermine the attractiveness to the banks of MIDFA-sponsored loans. Continued growth in the use of this mechanism may depend more on the public-spiritedness of private lenders than on financial incentives offered them. PIDA, on the other hand, actively advertises the fact that its financial arrangement both avoids the uncertainties inherent in tax exemption and guarantees to the private lenders the yield they desire. Furthermore, greater liquidity is achieved since the private lender carries only 50% of the loan whereas under MIDFA, the entire loan is carried by the lender at lower than conventional rates.

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C. ILA, Sections 440, 441, 441A

State loans to political subdivisions for land-banking, industrial park projects and shell building were authorized in 1972 under The Industrial Land Act. Although the legislation authorized the sale of \$6 million of state general obligation bonds, only \$4 million (sold in January 1973) has been made available to The Industrial Land Fund.

Section 440 offers loans up to 100% of market value of land with a limit of \$500,000 per project to subdivisions for the acquisition of industrial land. In its application, the county is required to state:

- 1) why the land is suited for industrial purposes;
- 2) for what industry it is best suited;
- 3) the likelihood of an industry or firm being interested in the land in the near future;
- 4) how use of the land would affect present zoning and other regulations;
- 5) how the project relates to a general industrial land acquisition plan if such exists for the county;
- 6) present employment patterns in the area and any anticipated changes in them;
- 7) whether there is a shortage of such land in the county and in the area of the project itself.

The Secretary of The Department of Economic and Community Development judges each application in terms of its likelihood of attracting industry and generating employment, its compliance with zoning and other applicable regulations, and a comparison of this project's anticipated economic benefits with those of other applicants in relation to total amount of funds available [25, Sections 440 (a) and 440 (b)] .

Section 440 does not intend the county to use land banking as a means of land use control: i.e. to preserve land from other types of development for a long period of time. A major point in both the appli-

cation and the approval procedures is the likelihood of use in the near future. The length of the repayment period, extending up to 40 years if partial sale or lease occurs, is a means of indirectly supporting long-term financing for businesses through favorable lease agreements between the county and the firm. Repayment by the county is required within 25 years if no sale or lease occurs, the implication being that the maintenance of undeveloped land is not considered a desirable or productive use of state funds under this program.

The local authorities are allowed to sell or lease the land to private users, upon 30-day written notice to the Secretary. If in his judgment the lease is not consistent with the purposes of Section 440, he may file a court action to enjoin the transaction [25, Section 440 (d) (1)] .

Maryland's Section 440 avoids one of the pitfalls encountered by programs in which land banking is performed by a state agency or board. The Maine Industrial Development Authority found land banking to be risky, primarily because of its dependence on local jurisdictions to provide infrastructure, such as sewers and streets. In Maryland, the initiative to purchase land rests with the counties and their application constitutes a prior commitment to cooperate in the development process.

The Massachusetts Government Land Bank, created in 1975, effectively combines both state control and local support. Land is purchased by the state Land Bank but only at the request of local authorities and after a mutually agreeable development plan has been arranged. A 40-year mortgage at a rate of interest equal to that of the state's general obligation bonds is provided to the local governmental authorities. They in turn may sell or lease the land to private users, but the Land Bank's approval must be obtained. The findings of the board of the Land Bank



in such matters are final. Under Maryland Section 440, however, ultimate approval rests with the courts and not with the Secretary of DECD, an arrangement which could cause costly delays in the development of the land in question.

With the exception of this last point, Maryland's program is very similar in effect to that of Massachusetts. One potential weakness is the \$500,000 limit per project under Section 440. This effectively restricts use of such funds to areas with very low land prices. As of the end of 1977, only one loan had been made - to Allegany County in 1973 for \$257,000.

State loans for planning and development of industrial parks under Section 441 follow the same pattern as loans for industrial land purchase. Information provided by the applicant county, the criteria by which the application is judged and the recourse to the courts are the same. Loans totalling \$1,584,000 have been made under Section 441, the earliest in 1974, the most recent, 1977, four to counties and one to Baltimore City. Only one, for \$750,000, approached the \$1 million project limit. The rest were for under \$500,000.

State support for speculative building is another form of indirect provision of long-term capital for fixed assets. Like land banking, it is a high risk activity because capital may be tied up for a long time while a user is sought. New Hampshire, which supported such construction in the mid-50's, found that buildings remained vacant too long and withdrew from the field. That Maryland makes provision for such loans under Section 441A is more a matter of interstate competitiveness than of enthusiasm for such a financial tool. Section 441A only became effective in July 1976. Since then, not one loan has been approved, although several applications have been made.



The Industrial Land Act has built into it a potential impediment to extensive use of this provision. In the information required of the applicant is a statement as to the lack of preexisting facilities within the jurisdiction - whether it be industrial land, industrial parks or shell-type buildings. If the proposed building would be in competition with preexisting vacant space, the application can not be approved. The definition of the uses of a shell building is so broad, (manufacturing, assembling, fabricating, processing, warehousing, research and development or office use [25, Section 441A (4)] that any area lacking in one such vacant facility is a rare bird indeed. Those jurisdictions wealthy enough to run the risk of paying off a 25-year loan usually face the problem of competition; those which lack vacant space often have insufficient funds to undertake the project in the first place.

D. Summary: Long Term Capital Provision

It is impossible to estimate a priori capital needs for Maryland, to determine how many firms with what financial requirements might be interested in further activity here. Thus it is very difficult to determine how effective present programs are in meeting long-term capital needs for business development. Certainly effectiveness cannot be judged in terms of volume of financial assistance since volume is as much a product of level of funding, life span of programs, and political support as it is of structure of programs themselves.

However one possible measure of effectiveness is the degree to which available funds are being used. No figures are available for dollar amount of IRBs outstanding at this time. Of MIDFA's \$80 million insurance limit, 36% is presently in use. Of ILA's \$4 million fund, 46% is on loan. This underuse may be an indication of lack of need for what is offered. Records kept by the Division of Business & Industrial Development, DECD, show that most of the firms which come to them have already lined up their financing, through either capital reserves or conventional arrangements with their banks. However what MIDFA offers is similar to that of PIDA and PIDA is extremely active.

More likely, lack of use results from two factors: that MIDFA and ILA have only recently gone into operation; and that they both lack visibility. Individual firms and the kinds of people who would bring business to these agencies often are unaware of their existence. Until very recently, MIDFA's interest in promoting itself has been hampered by DECD departmental policy. BID on the other hand has been prevented from advertising itself by an inadequate budget. MIDFA is presently embarking on a campaign to increase awareness of the availability of its service

and expects to do more business in 1978 as a result. However this campaign is not intended as a first step in an active promotional effort. BID remains at the mercy of the governor's budget.

All three programs, IRBs, MIDFA and ILA, have built-in defects which may adversely affect future use. IRBs and MIDFA are competing for the same market - private leaders, primarily local banks. It is perfectly acceptable practice for public sector programs to seek private sector involvement but participation can be guaranteed only if some advantage accrues to the latter. Public-spiritedness of the best-intentioned institutions is not infinite. Tax exemption may or may not be adequate enticement. Overuse of IRBs due to lack of coordination among issuing authorities, or changes in the national economy could destroy the market for tax-exempts entirely.

As far as ILA is concerned, the \$500,000 limit on 440 projects, the competition criterion in 441A projects and the lack of coverage for construction, not just rehabilitation, of buildings under 441 all serve as potential limits on future growth. Of the three, however, the industrial park program has the greatest chance of real growth.

One of the general justifications for the use of public monies to encourage economic development is the correction of perceived inadequacies in the private market - to wit, providing for the capital needs of small and medium-sized firms. Historically, Maryland's long-term capital programs have been ineffective with regard to small firms. The fixed costs associated with issuance of IRBs makes this mechanism too expensive in relation to the size of loans usually required by small businesses. MIDFA is empowered to give such aid, but its involvement is very limited, both as to dollar amount of assistance and as to types of small firms aided. A more affirmative policy to encourage expansion into the small



## V. PROVISION OF ALL OTHER FORMS OF CAPITAL IN MARYLAND

### A. Development Credit Corporation of Maryland

For all types of capital other than long-term, Maryland has only one source other than the private financial market - The Development Credit Corporation of Maryland (DCCM). Established by state legislation in 1958 (Article 23, Sections 412-429)[26] , is a privately-capitalized and privately-owned entity. For purposes of executive organization only, DCCM is listed as part of DECD, but in practice it is subject only to regulation by the Bank Commissioner of Maryland.

Article 23 states the purposes of DCCM as the encouragement of the location of new business in the state, the rehabilitation of existing business, the expansion of all kinds of business activity, and the furnishing of money and credit to the extent that such assistance is not otherwise readily available [26, Section 414 (a)] . The powers conferred on DCCM to carry out these purposes are almost limitless; in practice DCCM restricts its activity primarily to making loans. These are terms loans generally of 5 to 15 years in the range of \$25,000 to \$250,000 for equipment acquisitions, plant construction and working capital, or any combination of these. However, depending on the client's needs, loans for less than five or more than fifteen years may be made. Article 23 authorizes DCCM to charge an interest rate of  $4\frac{1}{2}\%$  above the prime rate prevailing in Baltimore City on unsecured commercial loans. Over the last few years, 4% above prime has been the usual charge.

DCCM takes a very different tack from other programs in its policy considerations. It is not concerned with employment per se. The amount of the loan is not weighed in terms of the number of jobs created, although DCCM likes to make loans which protect or create significant payrolls.

Nor is DCCM concerned with credit worthiness in the usual sense of the word. It is very liberal in its collateral requirements and in the equity position demanded of the applicant. Furthermore, many of its loans are to fledgling companies which have no credit history or past financial condition to examine.

DCCM is primarily concerned with two factors: that the funds they supply are adequate for the business to succeed in whatever it is attempting to do; and that the managerial staff has sufficient understanding of basic financial principles to be competent to handle the funds provided them. This is venture capital in the best sense of the word. DCCM can not guarantee the marketability of the product or service its clients sell; but it feels a strong obligation to ensure that failure is not due to lack of financial support and expertise [11] .

Although Article 23 authorized the sale of \$2 million worth of capital stock to fund DCCM, at present the total capital and surplus base (including undivided profits and reserves) is approximately \$700,000. DCCM's total indebtedness to its member banks is statutorily limited to ten times this base - \$7 million. However, Section 420a limits indebtedness to any one member bank to \$250,000 unless that bank is willing to lend more. Since the involvement of any single member is determined by the proportion of its capital stock and surplus to the total capital stock and surplus of all members, the effective limit on DCCM's activity is determined by the credit line set by the participating member with the largest proportional share. If \$250,000 were all that the largest bank offered, DCCM's present indebtedness could not exceed \$1.7 million. As it is, the members have suggested a \$5 million limit based on the \$750,000 line set by one bank with 14.5% participation. At present, \$3,860,000 is in use, 77% of its potential funding from member banks. There are no legal limits on the amount DCCM

may borrow from outside sources. Under its 501 program, The Small Business Administration has lent DCCM \$1.2 million to be used for loans. Thus, as of the end of 1977, DCCM's loans receivable totalled \$5,060,000.

That member banks have voluntarily agreed to a limit three times what is required by law is indicative of the degree to which DCCM has made participation in its programs attractive to its members: financially attractive. A DCCM loan provides two benefits. It protects the account of one of its members' customers; it also gives the bank of account the option of purchasing a direct early maturity participation in the loan, a 'first-out' position at 4% above prime. The combination of these two services provides a return to the banks which has stimulated their interest. The more they increase their participation, the more funds available for loans, the more the return to them. Financial incentives are equally strong for DCCM's staff, whose salaries are tied to efficient management and continued growth of the portfolio. DCCM is so structured that its profitability provides a built-in commitment on the part of both management and members to increase the amount of loans it makes for business development.

DCCM provides another service to members - protection of their loans to DCCM.<sup>8</sup> If a default occurs with an IRB, the issuing jurisdiction is not obligated to make good the loan. The bank's recovery depends on the adequacy of the collateral involved. In case of default MIDFA is obligated to repay that portion of the mortgage covered by insurance according to the schedule established by the mortgage insurance agreement. Recovery of the remainder of the loan again depends on the collateral involved. DCCM has four sources of funds available before the lending banks take a loss: the collateral from the borrower, DCCM's reserve for possible losses, its surplus, and its capital stock. If all these prove insufficient,

member banks are called upon to share in the loss on a proportional basis. The largest risk would be borne by the bank with 14.5% participation; this gives it an effective guarantee of the net loss of 85.5%. Most of the other members would have effective guarantees of 90% or better. Viewed in this way, a bank's participation in what are considered high risk loans seems less risky and more lucrative than investment in other types of programs. DCCM's record supports this suggestion; since 1970, no charge-offs have been made.



### B. Alternative Programs

The success of DCCM depends on the competence of its staff and the financial condition of its member banks. This is both its strength and its weakness. In the private sector, success belongs to those who earn it and vice versa. Unfortunately, DCCM is not just a private entity; it is also the sole source of medium-term expansion capital, short-term working capital and new business capital in Maryland. As such, the 'vice-versa' is not to be contemplated. However, there are programs in other states which might be used to supplement the activities of DCCM.

The New Jersey Urban Loan Authority is a state-funded agency that makes direct loans and 90% loan guarantees for both expansion and working capital for small and/or minority-owned businesses and professions. Started in 1971, its present capitalization is \$6 million. The Authority prefers to obtain commercial bank financing by offering a 90% guarantee. If this fails, it will make direct loans for up to \$250,000 for up to 10 years from its revolving fund. Interest rates vary but can range within one point of the federal reserve discount rate. Loans are not made for business start-ups or for refinancing. Security requirements are liberal; personal notes as well as equipment and fixed assets may be used.

Another source of medium and short-term capital is a "linked-deposit" plan. State surplus funds are selectively deposited in commercial banks to leverage loans either for specific geographic areas or for specific types of borrowers. The length of time for which the funds are deposited usually determines the length of loans generated. Under the California "Linked Deposit" plan, surplus funds are placed on a negotiated bid basis in banks for one year or more. In effect, the state accepts a lower rate of interest than it would normally get on a competitive bid basis in return for bank support of public development goals.

There are several difficulties involved with these plans. Collateral requirements to cover state funds may make participation by smaller banks difficult. California's requirement of 110 percent coverage in the form of treasury securities had to be liberalized to allow smaller banks to use surety bonds as well. State deposits for less than a year generate loans of such short duration that neither the state's nor the bank's purposes are well served. Such has been the case with the Illinois plan, which is planning to extend the deposits beyond the one-year period.

A new form of state support for expansion capital which is attracting interest in several states is the secondary marketing of SBA-guaranteed loans. Loans are purchased from the banks, thus freeing their capital for further lending. The banks benefit from increased liquidity and from fees they receive for servicing the loans. The state has increased potential funding for its development activities through investments which are low risk. Several states, among them North Dakota and Kansas, are developing such secondary markets, with state employee retirement funds emerging as major purchasers. The attractiveness of this position has not been lost on the private sector. Private brokerage firms also are developing a highly competitive market in which SBA-guaranteed loans are sold to individuals and institutional investors.

Few alternatives to DCCM exist for the provision of short-term working capital. The need for public involvement in this market is questionable. The private financial market appears to service most needs efficiently. Only a few states have programs of short-term working loans to aid small businesses unable to obtain conventional financing. In other states, development credit corporations fill the gaps in the private markets.

As of 1977, no state had a program specifically designed to assist new businesses. However, some states do provide financial aid on a very selective basis. The most interesting of these programs is the Massachusetts Community Development Finance Corporation. A public state corporation, CDFC is authorized to provide nearly all types of capital to new and existing businesses, ranging from stock purchases to long-term loans secured by fixed assets. However, assistance must be channeled through local community development corporations. It is also restricted to areas with a population of 15,000 or less where median household incomes are at least 15% lower than in the Boston SMSA. No operating capital is available under CDFC. Furthermore assistance is offered only if no other source of financing is available and if the local development corporation provides adequate supervision to ensure that public purposes are achieved.

CDFC was enacted in 1975 but has not yet received its \$10 million allocation. Since state general obligation bonds are supposed to be used for capitalization, the constitutional issue of use of public monies for private purposes has been raised. The issue hinges on whether CDFC aid is given to the local development corporations or directly to the businesses themselves. CDFC will be run by a nine-member commission, including representatives from the Departments of Administration and Finance (in which the Office of State Planning is located) Manpower Affairs, and Communities and Development [6, p. 29].

In the area of capital for new products and technological innovation, only Connecticut offers direct financial assistance although several states sponsor Science and Technology Foundations to act as intermediaries and information clearinghouses for inventors and entrepreneurs. The Connecticut Product Development Corporation is conservative both in its structure and

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its performance. A quasi-public venture capital corporation, it is directed by a six-member board of directors, all gubernatorial appointees. Four directors must have scientific, engineering, marketing or related experience; there is no requirement for representation of departments or line agencies on the board. CPDC's funding is controlled by the governor without whose approval no state bond issue may be sold. Of the \$10 million authorized by the legislature, only \$746,500 in capital has been provided. A \$300,000 grant from the National Bureau of Standards has raised the total capital fund to over \$1 million.

CPDC assistance is limited to new product development; it may not provide either working capital or equity for the investments. Although proposals from individual entrepreneurs, educational institutions or companies are all eligible, in view of the exclusion of working capital and equity, CPDC in practice deals with business firms that have a marketable product idea of their own or with individuals who are backed by a business entrepreneur. CPDC, to date, has made 17 project commitments; figures for the total dollar amount of involvement are not available. As compensation, CPDC receives royalties of about 5% of sales, with an upper limit of total dollar value set at five times CPDC's investment. There is also a stipulation in the contractual arrangement with participating firms that the employment and tax revenues generated by these projects should accrue primarily to Connecticut residents and businesses.

The proposed Massachusetts Technology and Development Corporation is a more flexible state venture capital program. It would support both new products and new technology by direct investment by means of capital stock and debt purchase as well as by royalty and patent contracts. Repayment from successful projects would be through stock dividends, capital appreciation as well as sales royalties and fees. MTDC assistance would

not be limited to preexisting firms. It would be able to co-venture new enterprises with private investment participation or provide guarantees for private investment. It would be authorized to purchase up to 49% of the voting stock of any business.

As planned, MTDC would be closely tied to overall state economic development efforts. Of its nine-member board, three would be required to be state development administrators. Furthermore, although MTDC would be a semi-independent, non-profit state corporation, it would be placed under an umbrella agency, The Massachusetts Community and Industrial Development Agency, for the specified purpose of coordinating MTDC's efforts with other development financing mechanisms within the state.

### C. Summary of All Capital Provision

The major impetus behind public sector financial assistance programs is the fear of interstate and interjurisdictional competition. Since such competition involves plant relocation and expansion, most states offer long and medium-term capital financing. Because such programs are almost universal, financial assistance has come to mean offering the most money for the least cost. As the use of these tools becomes more widespread, their competitive advantage in attracting or retaining industry disappears. Although some firms do shop around, in general locational decisions are not made on the basis of a one or two point spread in interest rates. What really matters is the availability of the particular type of capital needed by the business. In Maryland, there are sources other than the conventional lending institutions for all types of capital, except for new products or technology development; but the public sector provides only two - long-term and expansion capital. DCCM, a private entity, takes care of the rest.

From a supply and demand point of view, this arrangement may be adequate. DCCM states that it has never had to turn away an applicant for lack of funds. Neither MIDFA nor ILA has reached its limits. But from a structural point of view, this arrangement is questionable. The three major financing tools - IRBs, MIDFA and DCCM - all compete for the funds of the local commercial banks. The ability of the banks to respond depends not only on their good will but also on their own financial condition which in turn can be adversely affected by changes in the national economy or by internal activities.

Diversification is needed, not in types of capital available but in the means of providing them. DCCM's relationship with the banks seems productive; over IRBs, the state has no control. Reconsideration of MIDFA's

role seems the most logical move. The problem can be approached from two points, liquidity or interest rate. MIDFA could be reorganized along the lines of PIDA, where, by providing second mortgages at very low rates, the commercial bank is able to get its return without increasing the cost to the borrower. On the other hand, greater liquidity could be achieved by the development of a state secondary market in MIDFA loans, along the lines of what is presently being done for SBA-guaranteed loans. The time spans of MIDFA and SBA loans are similar; guarantees of up to 90% apply to both. And MIDFA loans, in practice, are a great deal more secure since MIDFA's default rate is miniscule. Whatever methods are considered, one point seems clear - that state funds could be used in a more direct manner to broaden the base of financial assistance programs.

## VI. FINANCING PROGRAMS AS TOOLS FOR COORDINATION

### A. Lack of Policy at State, Departmental or Agency Level

There are three general state objectives which its financing programs, MIDFA and ILA (BID) are intended to serve: 1) to make capital available when private capital market mechanisms fail; 2) to increase business activity so as to generate jobs and tax revenues; and 3) to balance economic activity in order to aid depressed areas. The first objective is implicit in MIDFA's enabling legislation. The thrust of legislative intent is to create a means by which state action can persuade the private sector to increase capital availability beyond already established levels. In the case of ILA, this objective is expressed in a negative way, in legal provisions discouraging use of ILA funds when other sources were available. The second objective is explicitly stated as legislative purpose in the enabling legislation of both programs. The third objective is expressed in MIDFA's requirement to waive its insurance premium in areas of high unemployment and is implicit in the Secretary of DECD's power to judge the economic impact of any application under ILA in terms of those of alternative projects in relation to the total funds available.

Inherent in these aims is a need for overall coordination of the effects of financial tools used in the state. The proper location of businesses, designation of growth areas, and trade-offs between industrial and environmental concerns are problems which increase in direct proportion to the success of financial assistance programs yet which can not be solved without some coordinative framework. The question arises as to the relationship between financial programs and coordination, to what extent they do or do not foster coordination among themselves and between state and local governments.



Financial programs are only one element of an overall economic development program. As such their primary function is the implementation of the program, not its creation. At the root of the problem of coordination in Maryland is the lack of any state policy, much less a 'plan', in this area. Policy is a political matter for which the governor bears primary responsibility. Policy may develop from the grass roots up or be imposed from the top; but in the end it is gubernatorial support which determines its success.

The importance of the role of the governor cannot be overstated. In Maryland, the budget is effectively controlled by him, since the legislature has only the power to cut, not to make additions. In this year, DECD has made a budget request to increase funds available for BID. In the budget submitted to the legislature by Acting Governor Lee, DECD's funds have been increased but the proposed allocation for BID has been cut. Instead, the increase has been earmarked for the Arts Council. No amount of legislative support can rectify this situation.

As head of the executive branch of government, the governor has at his disposal another means of promoting policy. Departments, agencies and authorities can be persuaded to follow his direction. In Massachusetts, the Massachusetts Industrial Mortgage Insurance Agency (MIMIA) is made up of a board appointed by the governor. In its enabling legislation, there are no locational constraints applied to applications. However the governor's economic policy advocates the location of new industry in heavily populated areas. MIMIA has made it apparent that it intends to be guided by administrative policy.

In the event that political support is lacking, financing agencies need strong internal links or legal authority to promote coordination. In Maryland, both of these are lacking.

Among the four major financing mechanisms there is little or no formal integration. IRBs are completely independent of the other three. Both MIDFA and BID (which administers ILA funds) are part of DECD but their formal connection is only through the Secretary. MIDFA operates as a semi-independent authority. The Secretary sits ex-officio on its board and its activities are technically subject to his review. The major linkage, however, is a provision (226-N) that the manager of MIDFA maintain close liaison with DECD to facilitate planning and financing of industrial plants. BID is an integral part of DECD, directly responsible to the Secretary. DCCM is a private corporation. However, at the time of its creation, someone was considering coordination of effort because Section 426 of Article 23 provides that a MIDFA board member may sit on DCCM's board, although all other state officials, elected or appointed, are specifically forbidden this privilege.

The authority to coordinate (as opposed to assisting, cooperating, encouraging, etc.) is not mentioned in the legislation concerning financing programs. Nor is any program provided adequate power to implement a coordinated policy. MIDFA's waiver of insurance premium is an extremely weak means of targeting funds. Analysis of economic impact is limited geographically to the jurisdiction in which the project is located. Under ILA, The Secretary of DECD may consider trade-offs in economic benefit among applications; but if the local jurisdiction enters into a sale or lease agreement which he feels is not consistent with the intent of the legislation, his only recourse is the courts. The agencies' power is essentially a negative one - to refuse funds. This raises the intriguing possibility that in Maryland implementation of state policy is best effected by inaction at the state level.

With neither a state policy, political support, formal linkages or legal authority, it is not surprising that there is no general policy agreed upon among financial agencies or within the agencies themselves. MIDFA, BID (and DCCM) describe themselves as 'reactive' programs. Their function is to assist a client achieve its goals. Each case is considered on an individual basis with no attempt to relate it to other applications or to evaluate it in the light of state priorities. If it suits the client's needs, alternative location sites are suggested by BID, but not with the intention of implementing a predetermined growth area policy. In MIDFA, and BID's eyes, attempts to steer firms are both unauthorized and impractical.

Practicality depends on by what route the client comes to the agency. BID administers ILA funds, but its primary role is to encourage business development by packaging financing, arranging for permits, smoothing the relationships between the firm and the appropriate authorities of the jurisdiction in which the firm will locate. If a firm comes directly to BID for assistance, BID may be in a position to persuade it to locate in a particular area. In general, however, businesses already have decided where they wish (or do not wish) to be. If alternative sites are pressed too hard, they have been known to leave Maryland altogether. If a firm goes first to a county economic development authority and then comes to BID for assistance, BID's hands are effectively tied. Even if the firm were not committed to the original jurisdiction, for BID to suggest a site elsewhere in the state would cause political uproar. The very knowledge that BID is honor bound to recommend alternatives if requested by a business, has made some local economic agencies unwilling to use its services at all.

MIDFA faces the same problem. Many of their clients are brought to them by local economic development commissions. For them to suggest another location would be suicidal. Thus, even if financial assistance offered by the state through MIDFA, ILA and BID in general were part of a coordinated development process at the departmental level, DECD lacks the power to direct those who use its services.

## B. Coordination of State/Local Development Efforts

Furthermore, there are no means of persuading local governments to use the assistance offered. If a given county is uninterested in development, that is the end of the matter. If a local jurisdiction is interested, it has its own financial tools, bonds, and the possibility of federal funding for some projects. The state can be bypassed. The initiative to use its assistance rests with the local governments, with little demanded in return.

Whatever coordination of state and local efforts does exist stems from the personal contacts developed among economic officials at both levels. MIDFA and BID maintain close ties, not for the coordination of policy but for the mutual promotion and advertising of their respective services. Both keep in constant touch with people throughout the state who are involved in the same kind of work - local economic development officials, bankers, industrial realtors, CPAs. These linkages may help coordinative efforts but they are totally dependent on compatibility of personalities.

Financial assistance programs as presently structured do not encourage state/local coordination in Maryland. However, they could be revised to do so. Issuance of IRBs could be made subject to review by a state agency as is done in Pennsylvania. The 10% equity investment by the borrower which MIDFA requests could be transferred to the local government along with costs of site purchase and development as is done under PIDA. Agreements reached under MIDFA and IRBs do not force a strong commitment to the project by the local government since none of its monies are at stake. More effective targeting of state assistance could be achieved along the lines of Massachusetts' CDFC and PIDA. The possibilities for revision are limitless.

Coordination, however, will not occur unless it is supported not only by the governor but also by the local governments themselves. At present, jurisdictions in Maryland are only concerned with their own development (or non-development). With few exceptions, there is no cooperation among them, even if such action would benefit another at no cost to themselves. They can not be persuaded to take a regional or state view; the change in attitude must come of their own volition. As the result of local parochialism and gubernatorial benign neglect, coordination becomes meaningless. 'State aim' is defined simply as 'the more businesses, the better'. If this is the accepted definition of state aim, then IRBs, MIDFA, ILA and DCCM should not be blamed for their failure to coordinate or evaluate. However, their effectiveness as financial incentives is questionable.

Footnotes:

1. The choice and description of all categories used in Section II of this report are taken from National Council for Urban Economic Development Information Service, Update: State and Urban Development--Part II, (Washington, D. C.) August 1977.
2. There is no single method of measuring size of firm which is accepted by business statisticians. Lacking such consensus, the author presents in this section the terms as they were used in the publication from which this analysis was taken. A definition of "small" will be offered later in this report.
3. All information presented in section III of this report is taken directly from the appropriate legislation, without analysis or commentary on the provisions mentioned.
4. The term "new business" is subject to several interpretations. Sometimes it is applied to expansions by existing firms. In other instances, it signifies an established firm which has moved into Maryland. In the context of this report, "new businesses" specifically refers to business start-ups which, by their very nature, lack the financial history needed to prove credit worthiness.
5. Unless otherwise noted, all information on other states' programs is taken from National Council for Urban Economic Development Information Service, Update: State and Urban Development--Part II, (Washington, D. C.) August 1977.
6. This analysis is based on unpublished data provided by MIDFA in February 1978.
7. Information on PIDA was obtained from brochures and interviews.
8. This line of argument was suggested to the author by [13].

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1. Development Credit Corporation of Maryland:  
W. G. Brooks Thomas, President, 1/13/78; 1/17/78 (telephone)  
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2. Maryland Department of Economic and Community Development:  
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Industrial Development, 12/21/77  
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3. Maryland Industrial Development Financing Authority:  
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Kenneth B. Frank, Assistant Attorney General, 2/6/78; 2/17/78 (telephone)
4. Massachusetts Office of State Planning:  
Ms. Susan Houston, Chief Planner, 1/13/78 (telephone)
5. Pennsylvania Industrial Development Authority:  
Gerald W. Kapp, Jr., Executive Director, 1/13/78 (telephone)
6. Prince George's County Economic Development Committee:  
John R. Sundergill, Economic Development Coordinator, 1/10/78
7. Task Force on State Economic Development,  
Center for Metropolitan Planning and Research Policy Committee:  
Richard G. Macgill, Jr., 1/6/78 (telephone)



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